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TAGS: [CH](#) [ECON](#) [EFIN](#) [EINV](#) [PGOV](#) [SOCI](#)  
SUBJECT: BEIJING LOOSENING RESTRICTIONS ON PROPERTY DEVELOPERS

REF: SHANGHAI 291 (FIRST CABLE OF THIS 2-PART SERIES)

11. (SBU) Summary: In recent weeks the Central Government has shifted from--in the words of one contact--"strangling" the property sector with regulatory restrictions to encouraging families to purchase homes. While this is not the direct aid that many struggling property developers were hoping for, it has resparked household interest and led to experimentation in housing policies by local governments. The Central Government's key theme has been affordable housing for low-income families. Others in power have used their bully pulpits to criticize housing costs that remain high, even after double-digit declines in some cities. For now, most local governments are most interested in jumpstarting land sales growth and the off-budget revenue that generates. End summary.

12. (SBU) This is the second of two cables on China's real estate sector in the first four months of 2009. The cables are the result of collaboration across the China Mission, with input and clearances from Beijing, Chengdu, Guangzhou, and Shanghai. EconOffs in those posts spoke with contacts over a period of several weeks in March-May 2009. This cable focuses on the Chinese government response to troubles in the real estate sector, and refel focuses on real estate sector trends--especially among households--and the impact on property developers and banks.

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Government shifting to support for the real estate sector . . .  
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13. (SBU) Chinese official policy has helped to pull the real estate sector back from the brink over the past few months, according to our contacts, even though the assistance did not come in the form of an industry stimulus plan, as some real estate players had hoped. According to official media accounts, the Central Government has focused on the long-term development of the real estate sector, rather than a short-term bailout. In

light of this, the bulk of the government's actions has not been in the form of direct aid, but rather in unwinding regulatory restrictions previously imposed. As a Shanghai-based investment analyst put it, the Central Government's "strangling" of the property sector beginning in October 2007 was a mistake, since the sector makes up one-tenth of China's GDP. Beginning in October 2008, said the contact, the government has allowed more regulatory breathing room.

¶4. (SBU) Measures undertaken by the Central Government include policies to encourage households to purchase and trade real estate, such as:

- Reduction of the minimum down payment from 30 percent to 20 percent for first-time homebuyers purchasing property of less than 90 sq. meters (implemented November 1, 2008).
- Reduction of the minimum mortgage interest rate to 0.7 times the benchmark mortgage rate (implemented November 1, 2008).
- Reduction of the property deed tax to 1 percent (implemented November 1, 2008).
- Temporary suspension of the stamp tax and the value-added tax on land sales (implemented November 1, 2008).
- Temporary suspension of business tax for individuals who sell "ordinary" housing they have held for two years or more, as opposed to the previous five-year threshold; reduction of this tax for sellers of "non-ordinary" housing (decision issued on December 20, 2008) .

¶5. (U) Other Central Government measures are targeted at reducing financing hurdles for property developers, including:

- Reduction of the minimum capital requirement for "ordinary" housing projects from 35 percent to 20 percent (announced May 27, 2009).
- Possible consideration by the Ministry of Commerce of

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reducing barriers to foreign investment in real estate (cited in local media June 22, 2009).

¶6. (SBU) In addition, some of our contacts highlighted official statements made at the National People's Congress session in early March. A Shanghai real estate sector contact told EconOff the industry was encouraged by the unprecedented emphasis that Premier Wen Jiabao gave to real estate in his work report--an impressive "560 words," according to our contact--the statement that "we must adopt even more proactive and effective policy measures to stabilize market confidence and projections, stabilize real-estate investments, and promote a stable and orderly development of the real-estate sector."

¶7. (SBU) Comment: The Central Government's relatively loose monetary policy in the first quarter is also affecting housing purchases. Directly, it is providing banks with ample liquidity to fund mortgages--in some cases without taking time for proper credit checks (see reftel). Indirectly, the government's monetary policy increases the public's inflation expectations, and some may be seeking real estate assets as a hedge. End comment.

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. . . and opening the door for local government initiatives . . .  
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¶8. (SBU) The Central Government has also opened the door for local governments to issue their own policies in the name of "stabilizing" the real estate sector, according to a December 17, 2008, statement by Premier Wen following a State Council meeting. Local policies announced since include:

- In Guangdong, 15 measures, such as allowing developers to delay their land premium payments for up to two years on parcels contracted for in 2008.
- In Chongqing, offering tax breaks for housing purchases, permitting outsiders who buy homes in downtown areas to apply for an urban Chongqing hukou (right to residence), and reducing land costs for developers.
- In Chengdu, among measures similar to those cities, raising the ceiling on loans from RMB200,000 to RMB400,000 and extending

mortgage repayment limits from 20 years to 30 years.

- In Shanghai, among similar measures, a program to create demand for new housing by accelerating demolition of aging housing. Vacant apartments are being purchased by state-owned companies in Pudong to rent at subsidized rates to financial and high-tech professionals.

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. . . but not too far  
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¶9. (SBU) As local governments experiment with loosening the center's restrictive real estate policies, sometimes central authorities have pushed back. For instance, the Shanghai-based investment analyst in early April reported that banks in none of the 40 cities his firm had contacted were enforcing the regulation that mortgages on second homes required a down payment of 40 percent. By May, China Banking Regulatory Commission Chairman Liu Mingkang issued a warning to banks to comply, which our contact who oversees the Shanghai financial services sector praised as an improvement in risk control. In another example, Chongqing in December attempted to implement an individual income tax deduction for mortgage payments, but the State Council signaled that the measure was not acceptable. The Ministry of Housing and Urban-Rural Development later announced that tax and fiscal policies to support real estate first had to be cleared with the center.

¶10. (SBU) Another measure that local governments across China

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have taken--so far without pushback from the center--is to quietly stop requiring builders to begin development of land within one year of purchase. According to a Beijing-based real estate expert, the government is not putting a completion date on projects, so even if construction does begin within one year, the developer can postpone completion indefinitely. A Guangzhou real estate consultant told EconOff that the one-year requirement has not been formally lifted, but companies are free to apply for an extension. A Guangzhou-based executive with one of China's largest real estate companies noted that a property is considered as being developed as soon as plans are submitted to the government, which can still be some time prior to the start of construction on a particular site. Another Guangzhou real estate executive was even more dismissive of this policy, "This is China," he said, "There are always ways." He went on to say that while the rule may be an issue for some foreign companies, local companies who maintained good relations with the government seldom have problems. In Chongqing, a real estate agent said that he knows of no actual application of the land development deadline rules, noting that local government does not want to "offend" developers.

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Emphasizing affordable housing . . .  
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¶11. (SBU) Several of our contacts in the real estate industry said that neither the central nor the local measures would offer much direct support to developers, since the emphasis is on affordable housing for low-income families. Developers had been hoping for a stimulus to support their bigger projects focused on the luxury market. A Beijing-based industry expert at the law firm Jones Day told EconOffs that some of the big developers believe the government is "forcing" them into the low-cost housing market, and they are opposed to entering a market with such a low profit margin. According to another Beijing-based source, some Chinese development companies are willingly entering the low-cost housing market to build goodwill with the government in order to pave the way for more profitable projects in the future. The principal investor in a South China real estate group told EconOff that real estate developers are not enthusiastic about Guangzhou's measures, which set limits on the maximum size of houses and the percentage of houses that must be for the mid and low-income market.

¶12. (SBU) In Shanghai, a local Urban-Rural Construction and Transportation Committee official told EconOff that Shanghai Party Secretary Yu Zhengsheng had publicly declared housing prices should not go higher, and that the industry should focus on affordable housing. Shanghai has announced a plan to build 20 million sq. meters of affordable housing: in 2008, work began on 4 million sq. meters, and in 2009 another 4 million will be started. In addition, Shanghai will launch a new tier of "affordable commodity housing," which will reach households that are too wealthy for traditional affordable housing but cannot afford market-rate housing.

¶13. (SBU) Other contacts criticized the various local measures as lacking specific details. Our Chongqing real estate contact said he "doesn't yet see how it will work," for although an operational deadline of December 2009 is set for several of the specific tax breaks and other measures to encourage housing purchases, other goals and measures have no specific implementation dates. (Comment: The speed of implementation for the real estate measures appears much slower than for those of other industries, such as tax breaks for automobile purchases. End comment.)

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. . . while talking down housing prices  
  
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¶14. (SBU) A contact at the China Academy of Social Sciences (CASS) voiced a theme common among government officials that housing prices remain too high. Our contact there said it is difficult to forecast housing prices for 2009, but he predicted that prices might fall 40 percent to 50 percent throughout China over the next two years. The CASS scholar pointed out that China has large amounts of empty floor space in urban areas which will take a long time to consume. In addition, he said that the income level and income growth of urban residents do not support housing price increases. The housing price to income ratio was 8:9 in China at the end of 2008, which is much higher than the reasonable international standard of 3:5. In Beijing, people cannot afford to buy homes even with housing mortgages from the banks, and they are waiting for prices to fall. His final explanation of further price decreases was a simple one--housing prices are dictated by land prices in China, and land prices depend on rent prices. When economic growth slows, rents decrease, thus causing a decrease in housing prices.

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Local governments eager to start selling land again  
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¶15. (SBU) While the slowdown in the China real estate market was orchestrated by central authorities, one of the biggest impacts was on local governments, which saw a sharp downturn in their revenues from land sales. According to E-House data, land sales throughout China fell 29 percent growth in the first four months of 2009, year over year, compared with 30 percent growth in the first three months of 2008. From 101 million sq. meters of land sold in the first four months of 2008, the same period this year saw only 73 million sq. meters sold. In this environment, most localities have begun withholding land from the market, hoping for prices to rise again.

¶16. (SBU) Our contacts indicate that local governments may be finding a shortcut to higher land sales prices. According to a senior contact at E-House, media reports of bidding wars over land parcels began to reemerge in April; however, several of the largest transactions actually appeared to be local state-owned enterprises that could have been directed to make the purchases. For instance, in Tianjin April's most expensive land parcel was sold to the Tianjin Songjiang City Construction Company, in Shenzhen the most expensive parcel went to Shenzhen City Shangmo Development Corporation, and in Hangzhou the most expensive parcel went to Hangzhou Shangcheng District Investment Company.

¶17. (SBU) Fewer land sales have meant lower local revenues. For instance, the Chengdu Development and Reform Commission reports sales down 80 percent in first quarter of 2009 compared with the same period in 2008. The general manager of a large local property developer in Chengdu further confirmed to EconOff that 2009 tax revenues will be down. Chongqing faces a similar situation, according to a real estate agent contact. The municipal government has relied heavily on land sales to fund the demands of infrastructure construction, but with the drop off in demand--19,000 sq mu sold in 2006, 16,000 sq mu in 2007, and only 5,000 sq. mu in 2008--Chongqing is turning to new ways to mitigate the impact on revenues, including bond sales. (Note: One mu = 0.16 acres. End note.)

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Comment  
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¶18. (SBU) Chinese leaders are torn between two opposing interests that are intertwined with the real estate sector. On

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the one hand, real estate is one of the key domestic sectors for generating internal investment and consumption--especially important for combating the effects of slowing growth of demand abroad. In light of this, some could argue a strong real estate stimulus package is needed. On the other hand, the return to labor from the high economic growth of recent years has been lower than the return to capital, leaving workers with incomes that have fallen behind the increases in housing costs. This has led some to argue against supporting property developers, since that would only be putting more profits in their hands.

¶19. (SBU) For now, Beijing appears to have decided to offer the bulk of policy support to households, through homebuyer incentives, while pushing property developers to contribute by keeping price increases to a minimum and supplying a greater percentage of affordable housing. However, the center's unleashing of the real estate sector has the danger of signaling to local governments that the punch bowl snatched away in October 2007 is now back on the table. Inflation will be worsened once expectations of a new housing boom trigger a surge in real estate investment--which has still not happened (see reftel)--since this would help drive up the international prices of upstream commodities such as steel. Households already are purchasing residences in part as a hedge against inflation, so the inflation spiral could be self-sustaining.  
CAMP